

Message Text

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ACTION EB-08

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TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00
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FM AMEMBASSY OTTAWA

TO SECSTATE WASHDC 2713

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ALL OTHER CONSULATES IN CANADA

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E.O. 11652: N/A

TAGS: EFIN, CA

SUBJECT: EXCHANGE RATE AND RESERVES DROP IN FEBRUARY:

"STABILIZING" THE DOLLAR?

1. SUMMARY: THE CANADIAN DOLLAR SANK TO 95.5 CENTS IN THE LAST TWO WEEKS OF FEBRUARY. FOREIGN EXCHANGE DROPPED U.S.\$407 MILLION. FINANCE MINISTER MACDONALD SAID ACTION MIGHT BE NEEDED TO STABILIZE THE CANADIAN DOLLAR, BUT A SPOKESMAN LATER DENIED THE GOVERNMENT HAS ANY INTENTION AT PRESENT TO ABANDON FLOATING. END SUMMARY.

2. AFTER HOVERING AROUND 95.5 U.S. CENTS DURING THE FIRST HALF OF THE MONTH, THE CANADIAN DOLLAR SANK OVER TWO PERCENT ON RUMORS OF A FURTHER DECREASE IN THE BANK RATE, ENDING THE MONTH AT 95.6 CENTS. THE AVERAGE DAILY VALUE OF THE CANADIAN DOLLAR OVER THE MONTH (20 TRADING DAYS) WAS 97.2 CENTS.

3. FINANCE MINISTER MACDONALD WAS QUOTED AS SAYING MARCH 1, "IT IS TRUE THAT AT A CERTAIN POINT -- I WON'T SAY UNCLASSIFIED

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WHEN -- THE GOVERNMENT MAY HAVE TO TAKE ACTION TO STABILIZE THE VALUE OF THE DOLLAR, BUT IN GENERAL WE'LL REMAIN WITH OUR FLOATING RATE POLICY."

4. HE ADDED THAT WHILE THE BANK OF CANADA DOES NOT SUPPORT THE DOLLAR AT ANY GIVEN LEVEL, IT DOES OF COURSE INTERVENE TO MAINTAIN ORDERLY MARKET CONDITIONS, WHILE

LETTING MARKET FORCES DECIDE THE DOLLAR'S VALUE IN THE FLOATING RATE SYSTEM. A SPOKESMAN LATER DENIED THE GOVERNMENT HAS ANY INTENTION AT THIS TIME TO ABANDON FLOATING.

5. MACDONALD'S STATEMENT CAME AFTER THE DOLLAR HAD DROPPED ONE CENT ON EACH OF THE TWO PREVIOUS FRIDAYS IN ANTICIPATION OF A POSSIBLE WEEKEND BANK RATE REDUCTION. IN EACH CASE IT FAILED TO RECOVER. THE SAME DAY, MARCH 1, FIGURES WERE RELEASED SHOWING RESERVES IN FEBRUARY THROUGH FRIDAY THE 25TH HAD DROPPED \$407 MILLION (SEE TABLE), REFLECTING INTERVENTION BY THE BANK OF CANADA TO STEM THE SUDDEN DROPS.

6. WHILE THE PRESS INTERPRETED MACDONALD'S STATEMENT TO MEAN THE GOVERNMENT MAY AGAIN TIE THE CANADIAN DOLLAR TO ITS U.S. COUNTERPART IF THE INTERNATIONAL VALUE OF CANADIAN CURRENCY DROPS SUBSTANTIALLY, FEW OBSERVERS EXPECT SUCH A DEVELOPMENT SHORT OF SOME SHARP DETERIORATION IN THE ECONOMIC OR POLITICAL CLIMATE.

7. A FAR MORE PROBABLE SCENARIO IS CONTINUED FLUCTUATION OF THE EXCHANGE RATE AROUND SOME MOVING EQUILIBRIUM, WHICH MIGHT WELL BE AT OR SOMEWHAT BELOW THE CURRENT 95-96 CENT RANGE. SMOOTHING INTERVENTION COULD BE EXPECTED ON BOTH UP AND DOWN SIDES OF FLUCTUATIONS, WITH LITTLE NET EFFECT ON THE BANK OF CANADA'S NET RESERVE POSITION OVER TIME. THIS HAS BEEN THE EXPERIENCE SINCE LAST FALL.

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8. HOWEVER, UNFORESEEN CHANGES IN MARKET PSYCHOLOGY WHICH THREATENED TO PUSH THE RATE DOWN TOO FAR OR TOO FAST COULD FORCE REEVALUATION OF CANADA'S RELATIVELY CLEAN FLOATING RATE POLICY. THE TIMING OF MACDONALD'S STATEMENT MAY HAVE BEEN DESIGNED TO DISCOURAGE SUCH ONE-SIDED SPECULATIVE PRESSURE FROM DEVELOPING.

9. TABLE

BANK OF CANADA INTERNATIONAL RESERVES AS OF (OPENING OF BUSINESS) FEBRUARY 28. FIGURES ARE IN MILLIONS OF U.S. DOLLARS.

COMPOSITION	RESERVES AS OF FEB. 28, 1977	CHANGE FROM JAN.31,1977
U.S. DOLLARS	2,881.1	(402.5)
OTHER FOREIGN CURRENCIES	16.6	4.1

GOLD	884.1	2.9
SDRS	552.7	1.8
RESERVE POSITION		
IN IMF	936.4	(13.8)
TOTAL	5,270.8	(407.7)

10. CHANGES IN RESERVES IN FEBRUARY INCLUDED AN INCREASE
OF U.S. \$7.6 MILLION IN SDR-DENOMINATED ASSETS, REFLECTING
APPRECIATION OF THE U.S. DOLLAR VALUE OF THE SDR.
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Disposition Comment:
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